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LFC INVESTMENT REPORT FOR THE QUARTER ENDING DECEMBER 30, 2012

This report details the comparative investment performance of the three investment agencies: the Educational Retirement Board (ERB), the Public Employees Retirement Association (PERA), and the State Investment Council (SIC). It explains how the returns generated by the three investment agencies differed from that of the archetypical fund and how their management and consultants added or subtracted value. Although the attribution analysis included in this report concentrates on the quarter, long term performance is indeed the most important metric. Therefore this report shows fund returns and comparative rankings for the one-year, three-year and five-year periods as well.

The fourth quarter of 2012 produced mixed results, with U.S. equity markets mostly flat and foreign markets markedly higher. The S&P 500 returned -0.38 percent, while the MSCI ACWI ex-U.S. (an equity index based upon a broad based world ex-US composite market) was up 5.8%. The Barclays Aggregate Core Bond Index returned a relatively flat 0.2%

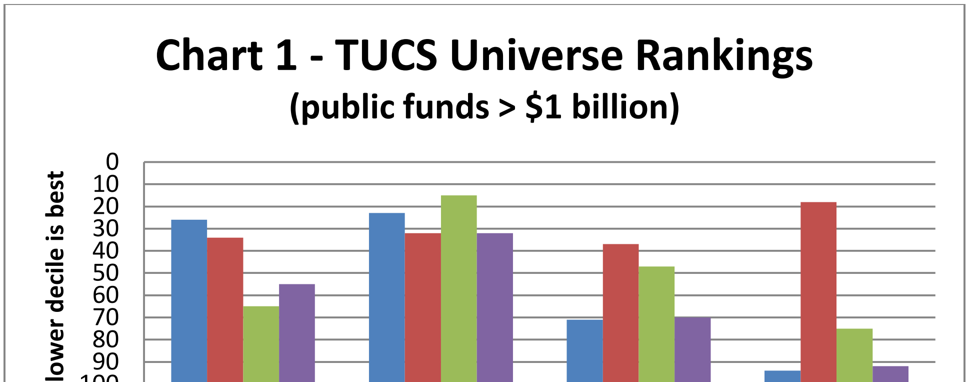
Table 1 shows ending balances and compares the investment agencies' percentage returns for the quarter and the one-year, three-year, and five-year periods with the S&P 500. The returns and balances of the Severance Tax Permanent Fund (STPF) and Land Grant Permanent Fund (LGPF) are shown separately. A portion of the STPF is invested in economically targeted investments that yield below market returns; the LGPF does not have economically targeted investments in its portfolio and so is a better gauge of SIC's performance. The difference in return between the two is a rough approximation of the opportunity cost of these initiatives.

Table 1
Returns and Ending Balances as of December 31, 2012

Returns (%)	PERA	ERB	LGPF	STPF	S&P 500
Quarter	2.52	2.3	2.01	2.1	-0.38
1-Year	13.94	13.6	14.45	13.52	16
3-Year	8.63	9.2	9.1	8.45	10.87
5-Year	1.18	3.6	2.34	1.32	1.66
Ending Balance ($B)	12.429	9.909	11.244	3.993	

Source: Agency Investment Reports

Chart 1 shows peer total return rankings for the agencies' large funds for the quarter, annually, and over a three year period. A lower rank (1st is best) denotes a better performance when compared to other funds. All of the comparisons are made using the Wilshire Trust Universe Comparison Service (TUCS), a benchmark for the performance and allocation of institutional assets that includes approximately 64 public funds with more than $1 billion in assets.



	Quarter	1 Year	3 Year	5 Year
PERA	26	23	71	94
ERB	34	32	37	18
LGPF	65	15	47	75
STPF	55	32	70	92

For the quarter, PERA ranked in the 26th percentile, better than their longer-term results. Its five-year ranking is slightly better than last quarter, but still near the bottom of all funds in the universe.

ERB returned a performance at approximately the top third, consistent with their one and three-year performance rankings, while ranking in the top 18 percent of funds for the five year period.

The funds invested by SIC fared differently, as indicated by the below median quarterly ranking of the land grant and severance tax permanent funds (LGPF and STPF). Both funds ranked much better in the one year period; the LGPF in the top 15 percent and STPF in the top 32 percent. In the three year period, the LGPF was just above the median while the STPF was below the median at the 70th percentile. Neither fared well in the five year period as both were in the lowest 25 percent.

Attribution Analysis. There are three basic ways that a fund's returns can differ from the average: the policy, allocation, and manager effects.

Quarterly Policy Effect. A fund can have a long-term policy allocation (known as the "policy index") target that has a more or less aggressive proportion of risky assets such as stocks. For example, risky domestic assets such as US stocks (equities) performed best in the first quarter. Accordingly, an index that has more domestic equities should outperform the average. Measured in isolation, such a change in performance is known as the "policy effect," and it is an essential responsibility of the fund's trustees. The most appropriate measurement of a policy allocation benchmark is comparison to a defined peer group.

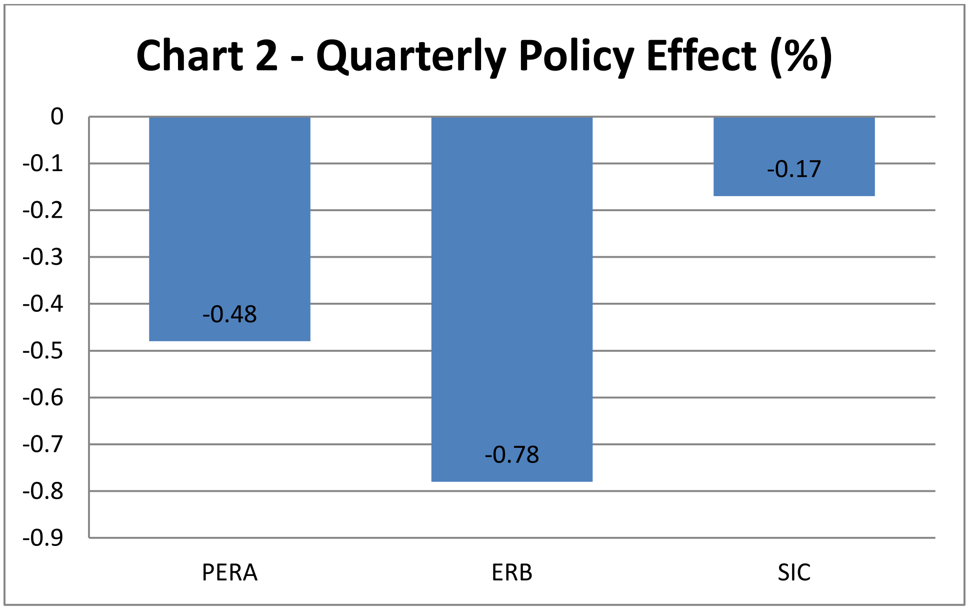


Chart 2 shows the funds' policy effect as measured by comparing the funds' policy indices to the TUCS median fund actual return. The TUCS median return is gross of the allocation and manager effects, and the measure is therefore a rough estimate of the policy effect. However, this report uses the TUCS for this measure to allow uniformity and consistency across the three funds. In isolation, PERA's policy allocation returned 48 basis points less than the median fund. PERA adopted new policy targets during the quarter, effective December 1st. Most notably, this raised the domestic equity target from 27 to 29 percent, lowered the international equity target from 27 to 20 percent, lowered the hedge fund target from 9 percent to 7 percent and added a "liquid alpha" allocation of 5 percent. The equity targets are now close to the median fund allocations. Given the mid-quarter target changes, it is difficult to fully analyze the reason for the negative policy effect for PERA.

The SIC's LGPF policy calls for a 37 percent allocation toward domestic equities, and a 15 percent allocation toward non-U.S. equities. The SIC's policy allocation delivered returns 17 basis points below the median fund. It should be noted that SIC is undergoing a restructuring of its investment portfolio that includes a change in its asset allocation policy to a more conservative exposure toward U.S. equities in favor of less volatile assets.

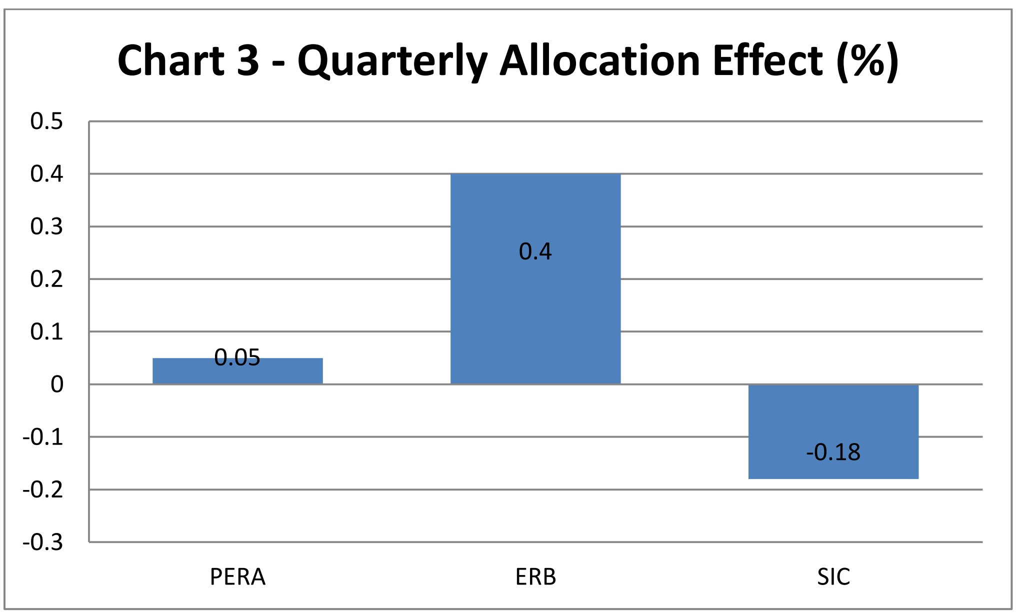
In contrast to both PERA's and SIC's policies, ERB's policy calls for a lesser exposure to equities (40 percent) in favor of fixed income assets. This less risky policy contributed to ERB policy index performing 78 basis points below the median fund performance.

Quarterly Allocation Effect. The second way that a fund's return can be affected is by tactically shifting assets away from the proportions called for by policy. This is a measure of the value added from a chief investment officer. For example, an investment officer might have had a bearish view of the stock market during the second quarter and used his authority to temporarily reduce a fund's risky assets to less than what is specified in policy. Because stocks had a strong quarter, increasing risky assets would have been a good market call and would have contributed to fund performance. As a matter of practice, investment officers are constantly confronted with allocation decisions when transitioning or rebalancing portfolio managers or asset classes. The investment officer may have the option of letting the money sit in cash or incurring the cost of temporarily covering the allocation through the futures market or some other avenue, depending on policy authority. It is important to note that tactical investment authority afforded the chief investment officer is dictated by investment policy, resulting in differing degrees of authority delegated by each fund.

The difference between the funds' temporary and long-term allocation is known as the "allocation effect" and is interpreted as investment return added or lost. Chart 3 shows the quarterly effect graphically; no funds gained value by deviating from their policy index. PERA gained 5 basis points from the market effect of overweight in international equities relative to the new policy targets.

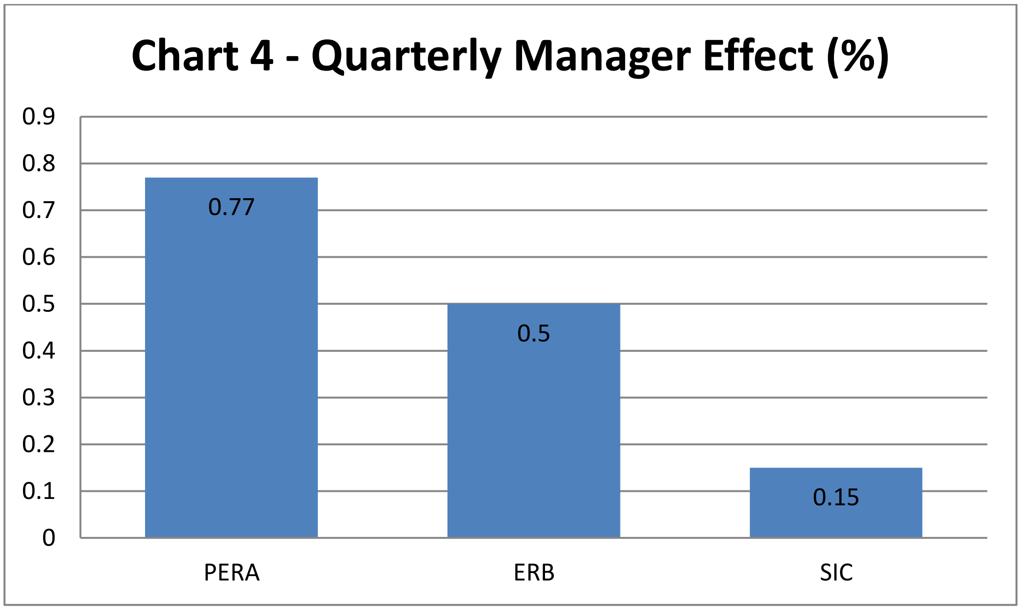
ERB's return was increased 40 basis points by being underweight core fixed income and overweight opportunistic credit relative to interim policy targets.

SIC's return was 18 basis points lower due to deviations from policy by being overweight fixed income assets and cash. Allocation gains or losses occur constantly – asset proportions vary against targets because of market price changes and incoming and outgoing cash flows, which are also variable.



Quarterly Manager Effect. The third way that value can be added or subtracted from a fund is through the use of active management. For example, a fund can buy a security such as the institutional version of the Standard & Poor's Depository Receipts (SPDRS) commonly used by retail investors. These securities are composed of a relatively fixed basket of securities that track the S&P 500 index. Alternatively, the fund can employ a manager who will trade individual securities given his attitude about the prospects of individual stocks. This is known as "active" investing. The difference between the return of the index and the portfolio of the active manager is known as the "manager effect".

As Chart 4 shows, all three investment agencies had positive manager effects for the quarter. PERA's managers added 0.77 percent to returns; ERB's managers added 0.5 percent, and the SIC added 0.15 percent[1].



The market environment and the funds' quarterly performance can be summarized as follows:

- Stocks were flat to slightly down in the U.S. while markedly positive in the international markets.
- In the U.S., the S&P 500 Index lost 0.4%, compared to gains of 6.4% in the second quarter.
- International markets posted returns of 5.8% during the quarter, compared to gains of 6.9% in the second quarter.
- Using the TUCS, it is possible to rank the funds against the same universe.
- PERA's return was above average for the quarter, nearly in the top quartile, primarily due to good manager performance during the quarter.
- ERB performance was in the top 34 percent, due to asset allocation and manager effects that more than offset the effects of a policy that relies on less risky assets.
- SIC quarterly performance was below the median. The investment agency's policy produced slightly less than the median fund. Asset allocation also detracted a like amount from returns, primarily due to overweights to fixed income and cash. While the agency's managers added value, it was not enough to offset the other two effects.

[1] The SIC notes that its net-of-fees performance analysis is based upon an estimate of SIC's investment performance developed by RV Kuhns.